

REPORT ON EXAMINATION
OF
SOUTHERN-OWNERS INSURANCE
COMPANY
LAKELAND, FLORIDA

AS OF
DECEMBER 31, 2003

BY THE
OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

LETTER OF TRANSMITTAL.....	-
SCOPE OF EXAMINATION.....	1
Status of Adverse Findings from Prior Examination.....	2
HISTORY.....	3
General.....	3
Capital Stock.....	4
Profitability.....	4
Dividends to Stockholders.....	4
Management.....	4
Conflict of Interest Procedure.....	6
Corporate Records.....	7
Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales through Reinsurance.....	7
Surplus Debentures.....	7
AFFILIATED COMPANIES.....	7
Tax Allocation Agreement.....	8
Administrative Services Agreement.....	9
ORGANIZATIONAL CHART.....	9
FIDELITY BOND AND OTHER INSURANCE.....	10
PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS.....	10
STATUTORY DEPOSITS.....	10
INSURANCE PRODUCTS AND RELATED PRACTICES.....	11
Territory and Plan of Operation.....	11
Treatment of Policyholders.....	11
REINSURANCE.....	12
ACCOUNTS AND RECORDS.....	13
Custodial Agreement.....	13
CPA Agreement.....	13
Risk-Based Capital.....	13

Information Technology.....	13
FINANCIAL STATEMENTS PER EXAMINATION.....	14
Assets	15
Liabilities, Surplus and Other Funds	16
Statement of Income	17
COMMENTS ON FINANCIAL STATEMENTS.....	18
Liabilities	18
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS.....	19
SUMMARY OF FINDINGS	20
SUBSEQUENT EVENTS.....	20
CONCLUSION.....	22

Tallahassee, Florida
February 11, 2005

Kevin M. McCarty
Commissioner
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0326

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316 Florida Statutes (FS), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2003, of the financial condition and corporate affairs of:

**SOUTHERN-OWNERS INSURANCE COMPANY
2710 WEST MEMORIAL BOULEVARD
LAKELAND, FLORIDA 33801**

Hereinafter referred to as the "Company". Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2001 through December 31, 2003. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2000. This examination commenced with planning at the Office, on July 6, 2004, to July 9, 2004. The fieldwork commenced on August 3, 2004, and was suspended as of September 1, 2004, due to coordination with the Michigan Office of Financial and Insurance Services examination of the parent company, Auto-Owners Insurance Company. The examination recommenced on January 31, 2005 and was concluded as of February 11, 2005. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

This financial examination was a statutory financial examination conducted in accordance with the Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code (FAC), with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination of liabilities, as those balances affect the financial solvency of the Company.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio report, the A.M. Best Report, the Company's independent audit reports and certain work papers prepared by

the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2003. Transactions subsequent to year-end 2003 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

Reliance was placed on work performed by the Michigan Office of Financial and Insurance Services after verifying the statutory requirements for the State of Florida.

Status of Adverse Findings from Prior Examination

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2000, along with resulting action taken by the Company in connection therewith.

Certificate of Authority

The Company had not written insurance coverage in the surety line of business for a period of two years.

Resolution: The Company removed that line of business from its certificate of authority.

Administrative Services Agreement

Although a general administrative services agreement existed, the agreement did not define the parent's specific obligations to the Company while maintaining possession of the Company's cash.

Resolution: The Company executed a new agreement, as of December 31, 2002, which specified the parent's obligations to the Company while it maintained possession of the Company's cash.

Short-term Investments

The Company had overstated amounts for acquiring and disposing of short-term investments on Schedule DA – Part 2.

Resolution: The Company corrected the amounts for acquiring and disposing of short-term investments on Schedule DA – Part 2. As of December 31, 2003, the Company reported no short-term investments on Schedule DA.

HISTORY

General

The Company was incorporated in Florida on August 24, 1994, and commenced business on June 15, 1995, as Southern-Owners Insurance Company.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2003:

Homeowners Multi Peril
Commercial Multi Peril
PPA Physical Damage
Mobile Home Multi Peril
Private Passenger Auto Liability
Commercial Automobile Liability

Glass
Burglary and Theft
Other Liability
Fire
Allied Lines
Fidelity

Commercial Auto Physical Damage
Earthquake
Boiler and Machinery

Inland Marine
Workers Compensation
Mobile Home Physical Damage

The articles of incorporation and the bylaws were not amended during the period covered by this examination.

Capital Stock

As of December 31, 2003, the Company's capitalization was as follows:

Number of authorized common capital shares	10,000,000
Number of shares issued and outstanding	3,550,000
Total common capital stock	35,500,000
Par value per share	\$10.00

Control of the Company was maintained by its parent, Auto-Owners Insurance Company, a mutual insurance company organized under the State of Michigan, who owned 100 percent of the stock issued by the Company.

Profitability of Company

The Company reported a net loss of \$138,602 for 2001. The Company reported net gains of \$4,132,781 and \$2,441,340, for 2002 and 2003, respectively.

Dividends to Stockholders

The Company did not declare or pay dividends to its stockholder in 2001, 2002, or 2003.

Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, FS. Directors serving as of December 31, 2003, were:

Directors

Name and Location	Principal Occupation
Herman Joseph Arends Lansing, Michigan	Chairman and CEO Auto-Owners Insurance Company
John Walter Fisher Lansing, Michigan	President Auto-Owners Insurance Company
Roger Lee Looyenga Lansing, Michigan	Executive Vice President Auto-Owners Insurance Company
Harry Edward Powell Holt, Michigan	Retired Officer Auto-Owners Insurance Company
Thaddeus Joseph Buda, Jr. Lansing, Michigan	Sr. Vice-President, General Counsel Auto-Owners Insurance Company
Stuart Roy Birn Lansing, Michigan	Sr. VP & Associate General Counsel Auto-Owners Insurance Company
James Franklin Anderton, IV East Lansing, Michigan	Businessman
Phillip Vern Frederickson Lansing, Michigan	Retired
Jeffrey Francis Harrold Lansing, Michigan	Sr. Vice President Auto-Owners Insurance Company
Ronald Herman Simon Lansing, Michigan	Sr. Vice-President Auto-Owners Insurance Company
Gregg Lynn Cornell East Lansing, Michigan	Retired
Mark Edward Hooper Okemos, Michigan	CPA
Lori Ann McAllister Silsbury Lansing, Michigan	Attorney

The Board of Directors in accordance with the Company's bylaws appointed the following senior officers:

Senior Officers

Name	Title
Herman Joseph Arends	President & CEO
Ronald Herman Simon	Treasurer
Thaddeus Joseph Buda, Jr.	Secretary

The Company's board appointed several internal committees in accordance with Section 607.0825, FS. Following are the principal internal board committees and their members as of December 31, 2003:

Executive Committee

Herman J. Arends¹
Roger L. Looyenga
John W. Fisher
Jeffrey F. Harrold
Thaddeus J. Buda, Jr.
Ronald H. Simon
Stuart R. Birn
Greg L. Cornell
Harry E. Powell
John F. Anderton, IV
Phillip V. Fredrickson
Mark E. Hooper
Lori M. Silsbury

Audit Committee

Phillip V. Frederickson¹
John F. Anderton, IV
Mark E. Hooper
Lori M. Silsbury

¹ Chairman

Conflict of Interest Procedure

The Company had adopted a policy statement requiring annual disclosure of conflicts of interest, in accordance with Section 607.0832, FS. No exceptions were noted during this examination period.

Corporate Records

The recorded minutes of the shareholder, board of directors, Audit and Executive Committee meetings were reviewed for the period under examination. The recorded minutes of the board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales Through Reinsurance

There were no acquisitions, mergers, disposals, dissolutions, and purchase or sales through reinsurance during the examination period.

Surplus Debentures

The Company did not have any surplus debentures as of December 31, 2003.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), FAC. The latest holding company registration statement was filed with the State of Florida on April 26, 2004, as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

The following agreements were in effect between the Company and its affiliates:

Tax Allocation Agreement

The Company, along with its parent, and other affiliates, (called the Auto-Owners Insurance Group) filed a consolidated federal income tax return. On December 31, 2003, the method of allocation between the companies was based upon separate return calculations, including current credit for net losses. The agreement called for the intercompany tax balances to be settled within thirty days of the tax filing, or thirty days of receipt of any tax refund.

Administrative Services Agreement

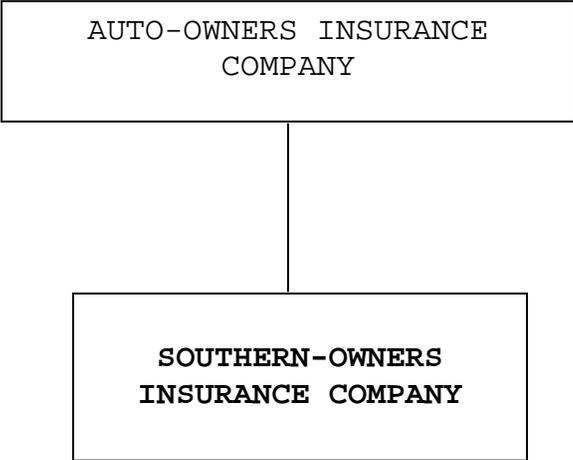
The Company entered into an agreement with its parent on January 1, 1995, by which the parent provided administrative services sufficient to carry on the normal business functions of a property and casualty insurance company. The Company had no employees and the directors and officers were shared with the parent company and other affiliated companies. The method of determining the cost of the services provided by the parent was based on the amount of time spent on the Company by executives and other department employees during the year. The administrative service fee was estimated during the year and monthly payments were made by the Company with a final invoice rendered by the parent before December 31.

In performance of the services rendered by the administrative agreement, the parent acted as both collection agent and disbursing agent for the Company. As the collection agent, the parent received all premium deposits in its depository bank account. The premium deposits were transferred into the parent's disbursement account on the following day. As the disbursing agent for the Company, the parent paid all expenses on behalf of the Company, including the Company's loss and loss adjustment expenses. The parent utilized its own bank checking account, along with checks showing Auto-Owners Insurance Company's name and address, for all disbursements of the Company.

A simplified organizational chart as of December 31, 2003, reflecting the holding company system, is shown below. Schedule Y of the Company's 2003 annual statement provided a list of all related companies of the holding company group.

**SOUTHERN-OWNERS INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2003



FIDELITY BOND AND OTHER INSURANCE

The Company was included with its affiliates under a Protection Plus Bond Insurance Policy with a limit of \$1,000,000 and a single loss deductible of \$25,000, which covered any fidelity and premise loss. The insurance adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC. The Company was also named with its parent and other affiliated companies, on a Directors and Officers liability policy, as well as professional liability insurance coverage.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company had no employees at December 31, 2003. Pension and insurance plans were provided at the parent level for all employees of the Auto-Owners Insurance Group. The Company participated in the Auto-Owners Insurance Group's Performance Appreciation Rights ('PAR'), a deferred compensation plan for certain officers and directors.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, FS, and with various state officials as required or permitted by law:

State	Description	Par Value	Market Value
FL	USTNTS, 7.25%, 08/15/04	\$ 275,000	\$ 285,398
FL	USTNTS, 7.25%, 05/15/04	925,000	946,099
FL	USTNTS, 7.875%, 11/15/04	800,000	845,752
TOTAL FLORIDA DEPOSITS		<u>\$2,000,000</u>	<u>\$2,077,249</u>

NV	USTNTS, 5.00%, 02/15/11	\$ 300,000	\$ 322,218
VA	USTNTS, 6.25%, 02/15/07	260,000	289,819
TOTAL OTHER DEPOSITS		\$ 560,000	\$ 612,037
Total Special Deposits		<u>\$2,560,000</u>	<u>\$2,689,286</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company was authorized to transact insurance in the following states, in accordance with Section 624.401(2), FS:

Florida	Illinois	Indiana
Iowa	Kentucky	Michigan
Missouri	Nebraska	Nevada
North Dakota	South Carolina	South Dakota
Utah	Virginia	Wisconsin

Treatment of Policyholders

The Company had established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS.

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim.

REINSURANCE

The reinsurance agreement reviewed was found to comply with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

The Company had one reinsurance agreement, which was between the Company and its parent, Auto-Owners Insurance Company. Pursuant to this agreement, the Company ceded 100% of the direct written premium and premiums assumed from pools, plans, and other mandatory insurance arrangements to the parent. The parent retroceded back to the Company 100% of all lines except Umbrella, Systems Breakdown, Liquor Liability, Mine Subsidence and/or Sinkhole, and/or Certified Terrorism as defined in "The Terrorism Risk Insurance Act of 2002", and as amended or any successor of such law.

The retrocession had loss limitations for property loss occurrence of \$200,000 per risk and \$850,000 per catastrophe property loss occurrence, with a maximum of two losses for each coverage. For liability and fidelity insurance, the retrocession limits loss to \$200,000 per occurrence with a maximum of four losses, but limited to a maximum of two losses for Products and Completed Operations.

The reinsurance contract was reviewed by the Company's appointed actuary and was utilized in determining the ultimate loss opinion.

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory basis financial statements annually for the years 2001, 2002 and 2003, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, FAC.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

The Company maintained its principal operational offices in Lansing, Michigan. This examination was conducted in Lansing, Michigan and also at the statutory home office in Lakeland, Florida.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company had a custodial agreement with Northern Trust Company, which was in compliance with Rule 69O-143.042, FAC.

Independent Auditor Agreement

The Company had an agreement with PriceWaterhouseCoopers LLP.

Risk-Based Capital

The Company reported its risk-based capital at an adequate level.

Information Technology

An evaluation performed by the IT specialist noted that the Company's parent, Auto-Owners Insurance Company, who provided all the operations necessary for the Company to function as an insurer, had not developed a business continuity plan.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2003, and the results of its operations for the year then ended as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

SOUTHERN-OWNERS INSURANCE COMPANY
Assets

DECEMBER 31, 2003

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$137,206,067		\$137,206,067
Stocks:			
Common	7,733,847		7,733,847
Cash:			
On deposit	759,377		759,377
Interest and dividend income due & accrued	1,869,435		1,869,435
Agents' Balances:			
Uncollected premium	5,320,885		5,320,885
Deferred premium	21,913,412		21,913,412
Reinsurance recoverable	135,019		135,019
Net deferred tax asset	4,227,130		4,227,130
Guaranty funds on deposit	90		90
Receivable from PSA	63,426		63,426
Aggregate write-in for other than invested assets	261,696		261,696
Totals	\$179,490,384	\$0	\$179,490,384

SOUTHERN-OWNERS INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2003

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$42,065,606		\$42,065,606
Loss adjustment expenses	9,778,320		9,778,320
Commissions payable, contingent commissions	2,246,400		2,246,400
Other expenses	997,973		997,973
Taxes, licenses and fees	2,782,257		2,782,257
Current federal and foreign income taxes	45,187		45,187
Unearned premium	50,085,882		50,085,882
Advance premiums	679,709		679,709
Ceded reinsurance premiums payable	2,512,800		2,512,800
Amounts withheld	322,830		322,830
Payable to parent, subsidiaries and affiliates	5,453,214		5,453,214
Aggregate write-ins for liabilities	86,420		86,420
Total Liabilities	\$117,056,598		\$117,056,598
Common capital stock	\$35,500,000		\$35,500,000
Gross paid in and contributed surplus	12,366,100		12,366,100
Unassigned funds (surplus)	14,567,686		14,567,686
Surplus as regards policyholders	\$62,433,786		\$62,433,786
Total liabilities, capital and surplus	\$179,490,384	\$0	\$179,490,384

SOUTHERN-OWNERS INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2003

Underwriting Income

Premiums earned	\$84,573,024
DEDUCTIONS:	
Losses incurred	52,758,500
Loss expenses incurred	7,274,006
Other underwriting expenses incurred	24,112,910
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$84,145,416</u>
Net underwriting gain or (loss)	\$427,608

Investment Income

Net investment income earned	\$5,107,527
Net realized capital gains or (losses)	<u>(33,249)</u>
Net investment gain or (loss)	\$5,074,278

Other Income

Net gain or (loss) from agents' or premium balances charged off	(\$136,648)
Finance and service charges not included in premiums	625,950
Aggregate write-ins for miscellaneous income	<u>(119,723)</u>
Total other income	\$369,579
Net income before dividends to policyholders and before federal & foreign income taxes	\$5,871,465
Dividends to policyholders	<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$5,871,465
Federal & foreign income taxes	<u>3,430,125</u>
Net Income	\$2,441,340

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$28,005,298
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Gains and (Losses) in Surplus

Net Income	\$2,441,340
Net unrealized capital gains or losses	998,346
Change in net deferred income tax	2,169,833
Change in non-admitted assets	(460,031)
Capital changes: Paid in	19,000,000
Surplus adjustments: Paid in	10,279,000
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>\$34,428,488</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$62,433,786</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses	<u>\$51,843,926</u>
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An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2003, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office actuary reviewed work papers provided by the Company and was in concurrence with this opinion.

SOUTHERN-OWNERS INSURANCE COMPANY
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2003

The following is a reconciliation of surplus as regards policyholders between that reported by the Company and as determined by the examination.

Surplus as Regards Policyholders per December 31, 2003, Annual Statement	\$62,433,786
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	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			
No adjustment necessary.			
LIABILITIES:			
No adjustment necessary.			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2003, Per Examination			\$62,433,786

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 2000 examination report issued by the Office.

Current examination comments and corrective action

The following is a brief summary of items of interest regarding findings in the examination as of December 31, 2003.

Information Technology

The Company's parent, Auto-Owners Insurance Company, who provided all the operations necessary for the Company to function as an insurer, had not developed a business continuity plan; however, no specific corrective action is required.

SUBSEQUENT EVENTS

Changes made to the management of the Company subsequent to the examination date are noted below.

Effective February 1, 2004, Henry J. Arends retired as CEO. Executive Vice-President, Roger L. Looyenga was appointed as CEO. Senior Vice-President, Jeffrey F. Harrold was appointed as Executive Vice-President.

During 2004, four major hurricanes have impacted the insurance industry in the State of Florida. These hurricanes occurred subsequent to the period of this examination and may have affected the Company's financial position. This examination does not include any assessment of the potential impact on the Company of the hurricanes; however, based upon preliminary information, anticipated losses are not expected to result in regulatory violations.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **SOUTHERN-OWNERS INSURANCE COMPANY** as of December 31, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$62,433,786, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Mary M. James, CFE, CPM, Financial Examiner/Analyst Supervisor, Dixon-Hughes, PLLC, and Joe Boor, Actuary, participated in the examination.

Respectfully submitted,



Rose Cady
Financial Examiner/Analyst II
Florida Office of Insurance Regulation